

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0073
Sales & Use Tax
Tax Period: 2002 - 2004

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ISSUES

I. Sales and Use Tax – Imposition of Tax

Authority: IC § 6-2.5-2-1, IC § 6-2.5-4-1, IC § 6-2.5-3-2, IC § 6-8.1-5-1(b); 45 IAC 2.2-3-8(b), 45 IAC 2.2-4-22(d), 45 IAC 2.2-3-9(e), 45 IAC 2.2-3-12(e), 45 IAC 2.2-3-9(d), 45 IAC 2.2-3-9(f); Information Bulletin #60, July 2006.

The taxpayer protests the imposition of use tax on property purchased pursuant to a time and materials contracts.

II. Tax Administration – Interest

Authority: IC § 6-8.1-10-1(a); IC § 6-8.1-10-1(e).

Taxpayer protests the interest assessed.

III. Tax Administration – Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the proposed assessment of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a contractor who performs commercial, residential, and industrial jobs in Indiana, Illinois, Michigan, and Ohio. It bills primarily on a lump sum basis, but also performs some time and material jobs. When working as a contractor for certain companies, the purchasing agents for those companies told the taxpayer not to pay sales tax on construction materials bought for the jobs. Taxpayer followed these instructions, and never paid use tax on the materials later. Taxpayer was also presented with direct-pay certificate from the purchasing agents.

An audit was conducted by the Indiana Department of Revenue ("Department"), which determined that taxpayer had failed to pay sales or use tax on construction materials, tools,

equipment, periodicals, and other items. Taxpayer conceded that some of the items were rightfully assessed, but argued that he did not owe use tax on the construction materials. A hearing was held to offer the taxpayer the opportunity to present his arguments. This Letter of Findings results.

I. Sales and Use Tax – Imposition of Tax

DISCUSSION

In accordance with IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. IC § 6-2.5-4-1 provides that a retail transaction involves the transfer of tangible personal property. Indiana imposes a use tax on tangible personal property stored, used, or consumed in Indiana when no sales tax was paid at the time of purchase. IC 6-2.5-3-2. All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC § 6-8.1-5-1(b).

The Department refers to 45 IAC 2.2-3-8(b), which states that:

All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

The responsibility for the payment of sales and use tax in situations where a contractor is installing tangible personal property on real estate owned by another is set out at 45 IAC 2.2-4-22(d) as follows:

A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax);

Pursuant to this Regulation, the contractor must collect sales tax and remit that sales tax to the state. If sales tax is not remitted, then under 45 IAC 2.2-3-9(e) “[w]ith respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner . . . He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.”

It appears that most of the use tax assessed was on material purchased for time and materials contracts. 45 IAC 2.2-3-12(e) provides that in a time and material contract, materials will be

taxed as long as materials are a separately identifiable transaction from labor costs. 45 IAC 2.2-3-12(e) does *not* state that if the sale of materials is not separately stated from the sale of labor then the sale of materials is not taxable. In either case, materials are taxable, just as if the materials were purchased for a lump-sum contract. 45 IAC 2.2-3-9(d) provides that a person, making a time and material contract for the conversion of materials into realty on land he does not own, must collect sales tax.

In any event, taxpayer also believed that because the purchasing agent told him not to pay sales tax, and that the purchasing agents were presenting him with direct-pay permits, it meant that the taxpayer did not have to pay either sales or use tax. However, the “disposition... will be exempt from the use tax only if the contractor received a valid exemption certificate, not a direct pay permit, from the ultimate purchaser or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.” 45 IAC 2.2-3-9(f).

Information Bulletin #60 is an important resource for contractors. It has been issued to help the public understand their obligation to pay Indiana sales tax on purchases for construction contracts, or use tax if the sales tax is not paid immediately upon purchase. It states that:

The general rule for the application of sales and use tax is that all sales of tangible personal property are taxable and sales of real property are not. This general rule is not changed when a construction contractor converts tangible personal property into real property by attachment. All construction materials purchased by a construction contractor are taxable.

The Bulletin also sets out instructions for contractors who perform lump-sum contracts and those who perform time and materials contracts. When purchasing materials, a contractor working a lump-sum contraction contract:

pays either: (1) sales tax at the time the construction materials are purchased, or (2) use tax at the time the construction materials are incorporated into real property if the contractor purchased or acquired the construction materials exempt from sales tax and the owner of the real property could not have purchased the materials exempt from sales tax.

On the other hand, a contractor working a time and materials contract:

is a retail merchant and may purchase the construction material exempt from sales tax but must collect sales tax on the resale of the construction material and remit the sales tax.

Information Bulletin #60 also states that “[a] construction contractor may not accept a direct pay permit in lieu of an exemption certificate.”

Taxpayer has reviewed the Information Bulletin, and concedes that the use tax assessed should be paid to the Department. As there is no legal basis for taxpayer’s previous position, his protest is denied.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Interest

DISCUSSION

Taxpayer protests the interest assessed and argues that it is an unfair burden, given that he was not informed of the relevant law.

Taxpayers who fail to file a return, to pay taxes, or who "incurs a deficiency upon a determination by the department," are subject to interest on the nonpayment. IC § 6-8.1-10-1(a). Interest continues to accrue until final payment is made. IC § 6-8.1-10-1(e) does not allow the waiver of interest by statute.

Taxpayer has not provided documentation in support of its protest of the imposition of interest, but more importantly, the Department is not authorized to waive interest under IC § 6-8.1-10-1(e). As such, the Department finds the assessment of interest proper and denies the interest protest.

FINDING

Taxpayer's protest is denied.

III. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) goes on to say that:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. Taxpayer has established to the Department's satisfaction that he exercised ordinary business care and prudence. Therefore, the Department will waive the penalty.

FINDING

Taxpayer's protest as to the imposition of penalty is sustained.